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SENSITIVE

SIPDIS

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SUBJECT: EXPANDING THE ENERGY REALTIONSHIP WITH BRAZIL: KUPFER
VISIT

REF: A) Brasilia 910, B) Rio 138, C) Rio 135

11. (SBU) SUMMARY: Acting Deputy Secretary of Energy Jeffery Kupfer and his delegation visited Brazil August 4 - 7. They met with a wide variety of private sector and government officials to discuss a broad range of energy issues. In Rio on August 4, Kupfer discussed primarily oil issues, in Brasilia on August 5 - 6, he explored options for bilateral cooperation and international issues, and on August 6 in Sao Paulo he focused primarily on developments in the biofuels sector. As a result of the trip, the bilateral energy relationship is primed to expand beyond biofuels cooperation to a broader, more developed relationship that will benefit both nations' quests for energy security. END SUMMARY

12. (U) THE PROGRAM: A/DS Kupfer, along with Senior Advisor Ben Getto, Director of Public Affairs Andy Beck, Acting DOE Assistant Secretary for Fossil Energy Jim Slutz (through Brasilia), and DOE international program staff, Carolyn Gay and Rhia Davis, visited Brazil August 4 - 7 to meet with a variety of private sector and government officials. In Rio, Kupfer visited the Petrobras research center CENPES to focus on biofuels and emissions research. He later met with Petrobras President Gabrielli, saw the head of the petroleum regulatory agency (ANP) Haroldo Lima, and had a dinner meeting with representatives of U.S. oil and gas industry. He also heard a variety of perspectives on energy at a roundtable with independent analysts, the head of long term planning for the government, and other industry representatives. In Brasilia on August 5, Kupfer had a luncheon meeting with a group of high level government representatives with interests in energy affairs, hosted by Minister of Mines and Energy (MME) Edison Lobao. This was followed by a somewhat smaller meeting at MME and a one on one meeting with the Minister. The next day he met with Ambassador Evarton Vargas at the Ministry of External Relations (MRE) to summarize his trip thus far and discuss bilateral cooperation and international energy agendas. Kupfer then proceeded to Sao Paulo where he held two roundtables on biofuels: one on trends in the biofuels sector, the other on research and development opportunities. Kupfer's visit received good press coverage; the result of an exclusive interview with O Globo, a press conference with Minister Lobao with a joint statement issued by Minister Lobao and Acting Deputy Secretary Kupfer, and a roundtable with international wire services.

TALKING OIL - PRE-SALT RESTRUCTURING AND OPPORTUNITIES

13. (SBU) Discussing oil writ large and the bilateral context, MRE's Vargas urged the USG to look at the vast new off-shore oil

discoveries (Note: over the course of the past year, Brazil has announced several discoveries of substantial reserves located in the pre-salt layer in the Santos Basin) from a political view, not just commercial. He underscored that Brazil had no intention of "becoming a Venezuela, totally dependent on oil." Kupfer acknowledged the GOB has to work through the issues associated with the new discoveries, but encouraged that clarity be provided to the global markets when practicable.

14. (SBU) Haroldo Lima, Director-General of the National Petroleum Agency (ANP), assured A/DS Kupfer that Brazil would continue to have an efficient and transparent process for industry to seek new exploration and production opportunities. While the national debate continues on how to regulate the pre-salt area (REFTELS), ANP is committed to ensuring a transparent process with clear rules that are uniformly applied, said Lima. He described with pride Brazil's previous nine bid lease auctions and explained that ANP is preparing for the tenth bid round sometime in 2009. The tenth round will not have pre-salt blocks for bid, but will have many other potentially lucrative off-shore and on-shore blocks. In particular, ANP wants to encourage the involvement of small and medium size companies and hopes to raise the profile of opportunities in Brazil's marginal and on-shore reserves. DOE Acting Assistant Secretary for Fossil Energy Jim Slutz agreed to follow-up with ANP on how to better promote opportunities for small and medium sized U.S. companies in Brazil.

15. (SBU) MME Minister Lobao told Kupfer that auctions for all pre-salt reserves had been suspended for the near term, because "we don't know what we're looking at in pre-salt yet." Lobao went on to confirm Lima's earlier comments about the upcoming tenth round and expressed a similar interest in attracting small and medium sized

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companies. He also unequivocally stated that no pre-existing, fully executed contract will be affected by the restructuring plans, although noted some potential for changes to contracts from the last bid round that are not yet fully executed. Later in a private meeting with Kupfer, Lobao shared his plans to recommend the formation of a national company to hold the rights of the pre-salt reserves under a production sharing agreement structure.

16. (SBU) Representatives of the U.S. oil and gas industry also suggested to Kupfer that they would benefit from a larger time window between the release of information from ANP and the deadline for submitting bids for bid rounds. Lobao responded to Kupfer's question on this topic the next day by saying that he would be willing to talk to ANP's Haroldo Lima to see if it was possible to grant broader time intervals, noting that the more bidders these auctions are able to attract, the better.

17. (SBU) U.S. industry also mentioned delays in environmental licensing due to environmental regulator IBAMA's policy constraints; however, they expressed cautious optimism at the stated plans of newly appointed Minister of Environment, Carlos Minc, to increase IBAMA's efficiency and cut licensing time in half. (Note: despite what some see as intractable systemic issues such as the fact that employees can be held criminally liable for problems associated with projects for which they grant licenses, IBAMA has quickly issued licenses for other major energy projects, such as the Rio Madeira hydro electric projects, since Minc's arrival in May.)

WHAT'S NEXT FOR PETROBRAS AND INDUSTRY?

18. (SBU) When asked to forecast supply over the next twenty years, Petrobras' Gabrielli responded that he didn't see any big changes in the near term. He noted transportation limitations in Russia, geological constraints for growth in the Middle East, time requirements to ramp-up offshore and oil sands production in Brazil and Canada, a general decline in Mexico, Venezuela, Norway and Nigeria, and tight refining capacity globally. Despite enhanced recovery techniques, Gabrielli does not foresee any significant impact on production and supply. He also does not foresee any big change on the demand side. He forecasts a generally tight market, with supply and demand each growing at 1.8 to two percent over the next five years. Beyond 2012, he predicts that Russia will build the necessary infrastructure and Canada and Brazil will increase

production as new projects come online. He also noted that the use of renewables and flex-fuel technology will need to increase.

¶9. (SBU) Petrobras President Gabrielli noted the global exploration bottleneck for equipment, but said that Petrobras is well positioned due to its aggressive equipment procurement strategy. It has 27 new rigs under contract for delivery over the next five years. Another 28 new rigs will be built in Brazil from 2013-17. This supply is enough to cover current operation plus potential new discoveries in the Santos Basin, Gabrielli said, and the size of the orders is comparable to expenditures under the U.S. Marshall Plan. U.S. and other international oil companies will be stretched thin in Brazil, but U.S. service providers are well positioned, he added. Specifically, he mentioned opportunities for U.S. firms for shipyard services, flexible rise plants, compressors, and the development of detail engineering offices.

¶10. (SBU) Petrobras is in the process of revising its international strategy to focus on domestic opportunities in the wake of the Santos Basin pre-salt discoveries, Gabrielli explained to A/DS Kupfer. However, the United States will remain an important part of the company's operations as USD 4 billion, or one-third of the company's planned investments abroad, will be invested over the next five years into the 300-plus blocks that Petrobras has in the Gulf of Mexico. Worldwide, Petrobras sees employee expertise and talent as a limitation on how extended it can be internationally.

¶11. (SBU) Tangential to oil developments, Gabrielli said there were logistical constraints in piping the associated natural gas to be produced from the new pre-salt discoveries from 300 kilometers (km) offshore (existing pipeline infrastructure only reaches 150 km offshore where production currently takes place). Petrobras is considering floating liquefied natural gas (LNG) technology to be able to transport the gas inland or to export it. LNG is advantageous since Petrobras doesn't need long-term contracts for LNG supply and can rely on purchasing spot cargos, as Brazil's peak

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season for LNG use is opposite that of North America and is only dispatched when dry conditions affect the supply of hydropower to Brazil.

¶12. (SBU) Downstream, Petrobras plans to add four new greenfield refineries to 2016, increasing refining capacity by 1.3 million barrels per day, build two large ethanol pipelines to move interior ethanol production to the ports of Sao Sebastiao and Paranagua for export, and build 72 tankers, all made in Brazil.

¶13. (SBU) Finally, Gabrielli highlighted the importance of the Carbon Sequestration Leadership Forum and of the development of sequestration technology. He mentioned the possibility of developing new technology for the Tupi field to inject CO2 to increase production.

COOPERATION OPPORTUNITIES -----

¶14. (SBU) During a luncheon meeting with Minister Lobao, his Deputy and all of his undersecretaries, as well as representatives from the Ministry of External Relations (MRE) and Ministry of the Environment, each of the attendees took a turn offering his opinion as to what might make fruitful areas for bilateral cooperation. In general, the Deputy Secretary responded that these were all issues the USG spends a great deal of time thinking about as well and there might well be some natural areas of cooperation.

¶15. (SBU) Marcio Zimmermann, MME's Deputy Secretary equivalent, emphasized several areas of interest that were later echoed by others. He said that cellulosic ethanol is a good area for collaboration, as are the alternative technologies of solar, wind, and thermal, since these are areas where the U.S. is fairly developed and Brazil is just revisiting, including by rejoining the IAEA group on alternative technologies since Minister Lobao took office. Highlighting Brazil's intention to build 4 - 6 new nuclear reactors by 2030, Zimmermann suggested that civil nuclear programs might be another possibility for cooperation. He also offered that

large-scale transmission was an area in which Brazil might have some expertise to share. The president of Electrobras, Jose Antonio Muniz Lopes, echoed the importance of many of these items and added energy conservation to the list. The MME Undersecretary for Strategic Planning, Altino Ventura Filho, also cited carbon capture and gasification of coal as ripe for cooperation.

¶16. (SBU) Rolando Schluck, MME Undersecretary for Electrification, suggested that the MOU of 2003 needs to be reactivated to incorporate these possibilities for cooperation. He added to the list the monitoring of the safety of the energy supply as well as technologies of decentralized generation due to the challenge of the many far flung secluded regions in Brazil. Paulo Roberto Costa, Director of Supply at Petrobras, discussed the ongoing cooperation with Japanese investor Mitsui and a Utah company in oil from shale as well as the need for U.S. commercial involvement in the development of oil infrastructure such as refineries. Claudio Scliar, MME Undersecretary of Mines and Geology, pointed out that there has been ongoing cooperation in the coal area and that the 1997 Implementing Agreement for Cooperation on Energy Technology was important to renew. He also stressed the importance of identifying some concrete items for collaboration and setting up corresponding working groups. During a meeting the next day, MRE's Vargas proposed that the 1997 Implementing Agreement be renewed. Kupfer said that the USG did not need the Implementing Agreement to cooperate with Brazil. However, if the GOB needed the renewal then "we could go forward on it."

¶17. (SBU) Minister Lobao summarized that there are many opportunities for us to pursue jointly and stressed that after Brazil's past experience with energy rationing, energy security is very important to the Brazilians. A/DS Kupfer agreed, saying we have the same concerns and deepening the relationship makes sense. He suggested that concrete deliverables be identified and suggested that we develop a mechanism to follow up. In the private meeting that followed, Kupfer invited Lobao to Washington and Lobao responded eagerly, ready to schedule a date, to which Kupfer replied that he would get back to him with specific timing after the visit. (Note: the Ambassador also passed a similar invitation from Commerce Secretary Gutierrez for a possible September visit.)

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¶18. (SBU) The suggestions offered during the luncheon and the follow up meeting comport with the Rio's energy experts' roundtable during which participants identified solar and wind technology and energy efficiency technology as good opportunities for U.S. companies in Brazil. They also highlighted the need to develop value-added industries, such as petrochemicals, around Brazil's existing energy-sector operations.

INTERNATIONAL INTERESTS

¶19. (SBU) GNEP - During the meeting with Lobao, Kupfer also pressed for Brazil to become a full member of the Global Nuclear Energy Partnership (GNEP), (Note: Brazil is currently an observer). Lobao responded that he would consult with MRE and send a response via the Embassy. Privately, Kupfer told Lobao that GNEP membership would not require giving up any sovereign rights, to which Lobao replied that the GOB does not plan to have nuclear weapons ever - now or in the future. In a later conversation with MRE U/S Everton Vargas, MRE's Chief of the Department of International Organizations Carlos Duarte said the GOB has two major concerns: (1) possibly curtailing the right to enrichment; and (2) possibly interfering with the international nuclear fuel market, but noted GOB agencies are meeting to consider GNEP membership. Kupfer pointed out that other uranium exporters with similar concerns had joined GNEP, including Canada. Duarte indicated a willingness to consider Amb. Sobel's suggestion that DOE send an expert to Brazil to meet with the appropriate officials to explain better how GNEP operates.

¶20. (SBU) Kupfer thanked Vargas for Brazil's supportive stance on India and nuclear energy. Vargas requested that the USG provide his staff, as soon as possible, a draft of the proposal on India to the Nuclear Suppliers Group. He added that he recently met with senior Indian officials and told them that Brazil wanted to help them on

this issue.

¶21. (SBU) Kupfer also raised the G-8 International Partnership on Energy Efficiency Cooperation with Lobao and later with Vargas. Lobao was noncommittal. Vargas explained that Brazil was interested, but miffed at not being invited to its launching in Japan in July. Until it received a formal invitation to join from the G-8 Presidency, Brazil remains "agnostic." Kupfer stressed that this initiative is just getting started and we would welcome Brazil's involvement on the ground floor. Kupfer noted Brazil's expertise in the efficiency arena and explained that Brazil could help "put meat on the bones" of this important international initiative.

BIOFUELS - COMMODITY AND FUTURES MARKETS NEEDED

¶22. (SBU) MRE's Vargas said Brazil is interested in research on second generation biofuels, but the costs are still too high with little additional benefits to sugar cane. Thus, he urged the USG to work on making ethanol an international commodity: a product traded on the Chicago and other commodity markets. At the energy experts roundtable in Rio, Adilson de Oliveira (Institute of Economics) and Alvaro Teixeira (Brazilian Institute on Petroleum, Gas and Biofuels-IBP) concurred that ethanol should be an international commodity and that the U.S. and Brazil should work together towards that goal. In particular, they mentioned the need for increased market access both in the context of Doha negotiations and U.S. tariff and non-tariff barriers. More importantly, global production capacity needs to be increased, said Teixeira. He explained that Brazil wants to help developing countries in Africa, Central America and Asia to become ethanol producers. Increased U.S.-Brazil cooperation at the technical level will be necessary to achieve the necessary scientific breakthrough on second generation ethanol.

¶23. (SBU) In a roundtable discussion at the Sao Paulo American Chamber of Commerce (AmCham), participants were largely pessimistic about the short-term prospects for the commoditization of ethanol although recent shipments by the Brazilian company COSAN, one of the world's leading ethanol producers, of ethanol are already happening for manufacture of E-10 in Saudi Arabia. They criticized the U.S. tariff on foreign ethanol as did UNICA's (Brazilian Sugarcane Industry Association) President Marcos Jank at a small reception at the Consul General's residence when he expressed his conviction that the Brazilian government will proceed with a WTO case against the U.S. ethanol program, and noted that UNICA would be supportive of

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the GOB case. The Sao Paulo AmCham business leaders noted however that a major impediment was also the US corn ethanol industry not being a more active/supportive international player to increase use of ethanol worldwide. Joel Velasco of UNICA noted that the prospects for developing ethanol industries in Central America and the Caribbean is complicated by domestic subsidies and international tariffs that make it more profitable to export sugar.

¶24. (SBU) COSAN representatives noted that ethanol is still a "political" commodity, making it difficult to predict the market. Participants generally agreed that the existence of a more predictable and robust market would allow producers to plan ahead for capital-intensive projects. It was suggested that an effort be made to bring venture capitalists to the table in discussing the future of the ethanol industry and that stakeholders work to create a fund to provide for public education on the benefits of ethanol production and use.

¶25. (SBU) Sao Paulo's AmCham industry leaders also emphasized the need to create a viable futures market and to expedite the standardization of contracts and specifications. The inability of investors to hedge themselves has reduced the availability of market liquidity, according to Joseph Tutundjian (Chairman of AmCham's Biofuels Task Force and head of the Brazilian firm Winner Comercio International). This, combined with a lack of global ethanol standards and specifications, has limited the growth of the international ethanol market. Tutundjian emphasized the need to negotiate a new standard contract for ethanol trading. The

participants generally agreed that Brazil's futures and commodities market (BM&F) did not have a sufficiently robust or useful market for trading ethanol and that on-going negotiations between the Chicago Mercantile Exchange and BM&F to agree to a standard contract were advancing slower than anticipated.

BIOFUELS - R&D

¶26. (SBU) Vargas urged the development of one or two concrete projects to show that the MOU produced action. He noted that the Brazilian private sector was very interested in seeing results from this cooperation. Highlighting one area of ongoing cooperation Dr. Carlos Tadeu Fraga of Petrobras discussed cooperation with DOE's National Renewable Energy Lab (NREL), working to commercialize the process by which residual sugarcane biomass is processed for second generation ethanol. Dr. Fraga explained that part of the bilateral cooperation between CENPES and NREL involves comparing research, harmonizing results, and eventually will include sharing test samples.

¶27. (SBU) In a roundtable discussion moderated by the Sao Paulo State Research Foundation (FAPESP), Brazilian scientists discussed the future of Brazilian biofuels from the scientific perspective. FAPESP's Glaucia de Souza discussed the Biomass Division program aiming to achieve transgenic advances in sugarcane in Brazil, described as analogous to corn in the U.S. 100 years ago. Current FAPESP-sponsored research is focused on creating insect resistant sugarcane and sequencing the entire sugarcane genome and the genetic structure of the cell wall, possibly leading to the discovery of an enzyme that can easily break down the wall, or improve on existing acid hydrolysis procedures to the same effect. FAPESP's BIOEN program is interested in collaborating with additional US researchers in the bilateral efforts.

¶28. (SBU) Souza emphasized that sugarcane uniquely offers both a high amount of sucrose for first generation ethanol production as well as an abundance of biomass for second generation use. FAPESP's Marcos Buckeridge argued that unlocking the additional energy stored in the biomass could triple the amount of energy available from the same amount of sugarcane. Jose Luiz Oliverio, Vice-President of capital-goods giant Dedini, expects to have the first commercially available products to process bagasse into second generation fuels by 2010. Given the high capital cost involved in second generation production, William Burnquist (Center for Sugarcane Technology, CTC) suggested that the U.S. and Brazil jointly invest in a binational second generation ethanol mill. (Note: Despite this research into second generation biofuels, over 80 percent of Brazilian R&D monies are spent on first generation technologies. End Note)

¶29. (SBU) While Souza praised the growing collaboration of

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Brazilian and U.S. universities, biofuels consultant Plinio Nastari offered two practical suggestions for furthering bilateral cooperation on the R&D front. Noting that U.S. grant funding laws prohibit grantees from conducting research outside of the United States, Nastari suggested that regulations be revised to allow for U.S. companies to conduct their research in Brazil where access to sugarcane feedstock is abundant. He also suggested that the U.S. and Brazil jointly fund a small travel program to facilitate the travel of cash-strapped biofuel consultants with a view to accelerate biofuels R&D.

¶30. (SBU) Moderator Carlos Henrique de Brito Cruz mentioned that the U.S. participation in the InterAcademy Panel on International Issues (IAP) is inactive at a time when ethanol has come under strong attack from other countries. He asked for U.S. representation from the National Academy of Sciences at the IAP's next meeting. A/DS Kupfer called on the scientific community to weigh in on the food v. fuel debate and noted that the voice of the scientific community adds significant credibility to a debate that has been made largely inter-governmental.

FOLLOW-UP

¶31. (SBU) Post identifies the following areas for follow-up action: designating central points of contact, establishing working groups, arranging a Washington visit by MME Minister Lobao, helping to identify small and medium-sized U.S. firms with interest in on-shore and shallow water exploration, renewing 1997 Implementing Agreement for Cooperation on Energy Technology, pursuing nuclear cooperation, exploring the possibility of providing expert consultation on GNEP, and considering the possibility of U.S. participation at the Inter-academy panel on international issues.

¶32. (SBU) COMMENT: The visit by A/DS Kupfer is the first of a series of 3 strategic high profile visits to Brazil focused on the energy sector. State Department Undersecretary for Economic Affairs Reuben Jeffery is planning a visit in the coming months with a specific focus on the biofuels MOU, as well as the wider array of energy issues between our two countries. In October, Commerce Secretary Gutierrez will visit for the CEO forum and will bring attention to opportunities for U.S. companies in Brazil's energy sector. Kupfer's visit successfully started the process by highlighting U.S. interest in the sector and helping to identify opportunities for collaboration. We have an opportunity to institutionalize these relationship-building and energy security-enhancing collaborations. Designating central points of contact for each side and establishing working groups will be the first steps in ensuring that the results of this visit reach their full potential.

¶33. This message was produced jointly by Embassy Brasilia, Congen Rio and Congen Sao Paulo, and cleared with DOE.

SOBEL